R5650-2A

JAPAN · ECONOMIC · INSTITUTE

JEI

REPORT

A Two-Part Report: A and B

NO. 20A May 24, 1991

JAPAN'S ECONOMIC RELATIONS WITH AUSTRALIA: MEETING THE CHALLENGES OF INTERDEPENDENCE

Summary

Australia's long-running surplus in trade with Japan stands in marked contrast to the experience of the United States, yet similar problems have soured both countries' economic relations with Japan. Drawing on its vast natural resources, Australia supplies bulk commodities to Japan, which ships back capital and consumer goods and channels money into mining projects and real estate purchases, especially tourist-related facilities. Despite the surplus, Canberra complains that Japanese companies seem uninterested in buying Australian manufactured goods other than low value-added products. Moreover, Canberra contends, Japan's business community appears reluctant to transfer technologies that could strengthen Australia's competitiveness in high value-added goods.

The influx of Japanese tourists to Australia and related investment capital comes at a time when Australians are reexamining their historic economic and political ties to Europe. Good relations with their Asian neighbors, especially with economic superpower Japan, are important for Australia's perception of its economic and political roles in the changing world order. At the same time few Japanese seem to realize the great impact of their economy on Australia, which, in some cases, has created tensions in Australian society. Coming to grips with the economic interdependence of Japan and Australia and the problems generated by this type of relationship represents one of the major challenges facing Tokyo and Canberra.

Structure of Japan-Australia Trade

Japan generally has viewed trade relations with Australia as being driven by its own imports rather than its exports. Until relatively recently Japanese trade policy gave a high priority to finding stable supplies of agricultural and industrial inputs as well as to promoting the sale of manufactured products overseas. Australia, with its rich natural resources and its geographical proximity to Japan, was an ideal supplier of wool, iron ore, coking coal and a long list of other bulk commodities or semiprocessed materials. Last year Australia supplied 62.5 percent of Japan's wool imports, 43 percent of its iron ore requirements and 45.5 percent of the foreign coking coal bought by Japanese steel mills. After the twin oil crises of the 1970s Japanese industry worked to diversify its energy mix and its supply sources to be less dependent on Middle Eastern oil. Australian steam coal, which provided 69.1 percent of Japan's 1990 imports of that fuel supply, was a major alternative source for electric utilities and big industrial users.

Australia also had the largest share of Japan's imported beef market in 1990 -- 52.1 percent. Moreover, it supplied 38.8 percent of raw sugar cane imports and 18.5 percent of purchases of nonferrous ores. In value terms over three-fourths of Japan's imports from Australia last year consisted of agricultural and industrial inputs; adding in purchases of such industrial supplies as nonferrous metals boosted the figure for natural resource-based imports to around 90 percent (see Table 1). Even though manufactured products made up 50.3 percent of Japan's 1990 imports, the composition of its purchases from Australia put that country in a virtual tie for the number-two supplier spot with Indonesia, Japan's third-largest source of crude oil and the top seller of liquefied natural gas (see Table 2).

Almost mirroring the dominant role of primary commodities in Japan's imports from Australia is the concentration of Japan's Australia-bound shipments on machinery and transportation equipment, particularly cars and trucks. But Australia always has been far less important as a market for Japanese exporters than as a supplier to these same manufacturers, ranking ninth on the list of Japan's biggest customers in both 1989 and 1990. That fact has kept the country's trade with Australia in the red for the last 31 years (see Table 3).

From the Australian viewpoint Japan is its largest customer as well as its second-largest supplier. From July 1988 to June 1989 -- Australia's FY 1988/89 -- sales to Japan represented 27.3 percent of Australia's exports; this was nearly three times the figure for the United States. Its foreign suppliers are almost balanced, however; the European Community accounted for 22.9 percent of Australia's imports in FY 1988/89, the United States 21.5 percent and Japan 20.7 percent (see Table 4). But unlike the surplus Australia runs in trade with Japan, imports from both the United States and the EC far exceed exports to those trading partners.

Impact of Exchange Rate Changes On Australia's Trade

Its expanding surplus with Japan notwithstanding, Australia's overall trade (exports f.o.b., imports c.i.f.) was in deficit throughout the first half

The JEI REPORT (ISSN 0744-6489) is published weekly except for the New Year, Memorial Day, Labor Day, Thanksgiving and Christmas holiday weeks for $40 per year by the Japan Economic Institute of America, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036. Second class postage paid at Washington, D.C. POSTMASTERS: Send address changes to JEI REPORT, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036.

Table 1: Commodity Composition of Japan's Trade with Australia, 1990

(in millions of dollars; exports f.o.b., imports c.i.f.)

Exports	Amount	Share
Food	$34.8	0.5%
Textiles and Apparel	158.8	2.3
Synthetic Fabrics	47.6	0.7
Chemicals	305.2	4.4
Plastic Materials	85.8	1.2
Nonmetallic Mineral Products	88.1	1.3
Metals and Fabricated Metal Products	356.9	5.2
Steel	221.6	3.2
Nonferrous Metals	22.5	0.3
Fabricated Metal Products	112.7	1.6
Machinery and Transport Equipment	5,338.2	77.4
Nonelectric Power Generating Machinery	175.1	2.5
Computers and Other Office Machines	485.8	7.0
Metalworking Machinery	57.2	0.8
Bearings	39.7	0.6
Electric Power Generating Machinery	49.4	0.7
Televisions	26.0	0.4
Radios	48.3	0.7
Electronic Tubes and Semiconductors	53.6	0.8
Motor Vehicles	2,062.9	29.9
Motorcycles	49.6	0.7
Ships and Boats	168.7	2.4
Scientific and Medical Equipment	245.4	3.6
Videocassette Recorders and Players	169.9	2.5
Other	618.4	9.0
Tires and Tubes	152.1	2.2
Total Exports	6,900.3	100.0

Imports	Amount	Share
Food	$1,972.5	15.9%
Meat and Meat Products	899.5	7.3
Fish and Fish Products	261.5	2.1
Wheat	182.3	1.5
Sugar	204.9	1.7
Textile Fibers	857.0	6.9
Wool	693.5	5.6
Cotton	162.7	1.3
Metal Ores and Scrap	2,234.3	18.1
Iron Ore	1,315.3	10.6
Steel Scrap	23.9	0.2
Nonferrous Ores	801.9	6.5
Other Raw Materials	434.5	3.5
Hides and Skins	110.7	0.9
Crude Nonmetallic Minerals	214.2	1.7
Mineral Fuels	3,948.7	31.9
Coal	3,004.2	24.3
Crude Oil	255.0	2.1
Chemicals	121.5	1.0
Machinery and Transport Equipment	176.9	1.4
Computers and Other Office Machines	22.1	0.2
Nonelectric Power Generating Machinery	27.2	0.2
Other	2,623.6	21.2
Steel	62.3	0.5
Nonferrous Metals	1,072.9	8.7
Total Imports	12,368.8	100.0

Source: Japan Tariff Association

Table 2: Japan's Major Trading Partners, 1990

(in millions of dollars; exports f.o.b., imports c.i.f.)

Exports	Amount	Share	Imports	Amount	Share
United States	$90,322.4	31.5%	United States	$52,368.6	22.3%
West Germany	17,782.0	6.2	Indonesia	12,721.3	5.4
South Korea	17,457.2	6.1	Australia	12,368.8	5.3
Taiwan	15,429.8	5.4	China	12,053.5	5.1
Hong Kong	13,071.9	4.6	South Korea	11,706.7	5.0
United Kingdom	10,786.1	3.8	West Germany	11,487.1	4.9
Singapore	10,707.8	3.7	Saudi Arabia	10,461.6	4.5
Thailand	9,126.0	3.2	Arab Emirates	9,084.6	3.9
Australia	6,900.3	2.4	Taiwan	8,496.4	3.6
Canada	6,726.5	2.3	Canada	8,392.2	3.6
Total Exports	286,947.5	100.0	Total Imports	234,798.6	100.0

Source: Japan Tariff Association

Table 3: Japan's Trade with Australia, 1960-90

(in millions of dollars; exports f.o.b., imports c.i.f.)

Year	Exports	Imports	Balance
1960	$144	$344	$-200
1965	313	552	-239
1970	589	1,508	-919
1975	1,739	4,156	-2,417
1980	3,388	6,982	-3,593
1985	5,379	7,452	-2,073
1986	5,227	6,980	-1,753
1987	5,146	7,869	-2,723
1988	6,680	10,285	-3,604
1989	7,805	11,605	-3,800
1990	6,900	12,369	-5,469

Source: Japan Tariff Association

of the 1980s. The international currency realignments set in motion by the September 1985 Plaza Accord only compounded Australia's problems. The Australian dollar depreciated against the yen, falling from Y165 in June 1985 to Y105 as of June 1988; it also fell against major European currencies. It increased, however, vis-a-vis the U.S. dollar, rising from 66.4 cents to 80.9 cents over the same time frame. Since the bulk commodities that make up most of Australia's exports are priced in U.S. dollars on the international market, the Australian dollar's higher value undercut Canberra's efforts to boost foreign sales. Moreover, the Australian dollar's depreciation against the yen and European currencies upped the cost of imports from Japan and the EC. To make matters worse, the growth of world trade in primary commodities in the second

Table 4: Australia's Major Trading Partners, FY 1988/89*

(in millions of Australian dollars**)

Exports	Amount	Share	Imports	Amount	Share
Japan	A$11,840	27.3%	United States	A$10,129	21.5%
United States	4,422	10.2	Japan	9,766	20.7
New Zealand	2,210	5.1	Great Britain	3,454	7.3
South Korea	2,174	5.0	West Germany	2,951	6.3
Hong Kong	1,888	4.3	New Zealand	1,970	4.2
Taiwan	1,566	3.6	Taiwan	1,920	4.1
Great Britain	1,521	3.5	Italy	1,382	2.9
European Community	6,002	13.8	European Community	10,775	22.9
Total Exports	43,409	100.0	Total Imports	47,073	100.0

*From July 1988 to June 1989.
**A$1.00=U.S.$0.755 as of June 1989.

Source: Australian Bureau of Statistics

half of the 1980s generally lagged that of manufactured products. By yearend 1989 Australia's trade deficit, which had totaled $455 million in 1980 and just under $3.2 billion in 1985, had swelled to $7.3 billion.

With the trade deficit soaring and inflation again on the rise, Canberra undertook a review of its industrial and trade policies with the aim of promoting production and exports of manufactured goods. The government began to dismantle protectionist measures for domestic manufacturers as a way of fostering an export-oriented manufacturing sector capable of meeting international competition head-to-head. Although academics may regard Japan-Australia trade as a good example of the international division of labor, Canberra saw the country's dependence on exports of primary commodities as implying a long-term deterioration in its terms of trade.

The yen's appreciation between 1985 and the end of 1988 coincided with a period of expanding domestic demand in Japan. These parallel developments hiked imports of manufactured products. But even though overall Japanese purchases of foreign manufactures jumped from $40.2 billion in 1985 to $118 billion last year, Australia's exports of metals, chemicals, capital and consumer goods, and similar products to Japan remained basically unchanged. That situation has led to Australian claims that Tokyo ignores Canberra's requests for improved market opportunities in Japan for domestic suppliers of manufactured products while acceding to the market access demands of the United States and Europe, with which Japan runs large trade surpluses. Adding to the bilateral friction is the high public visibility of Japanese-made manufactured products, especially consumer goods, in Australia. Although the country sells more to Japan than it buys, this profile has led to charges that Japanese producers have targeted Australian markets.

Problems in the Manufacturing Sector

Japanese manufacturers dismiss these charges as off-target. The relatively strong showing of made-in-Japan products in Australia, they say, stems more from the country's underdeveloped industrial sector than a market drive by Japanese competitors. With a population of only 17 million spread over an area equal to about 82 percent of the U.S. land mass, Australia is a small market, and that hinders achievement of the economies of scale necessary for efficient production of consumer or capital goods. Moreover, limited economic infrastructure, particularly in the transportation area, restricts domestic industry's development. The ability of agriculture and mining to foster the economy's expansion over the years and provide a fairly high standard of living for Australians also is cited as a reason the country has not pushed harder to develop its manufacturing industries.

Even though the government has campaigned for Australians to buy domestic, sales of foreign-made goods remain high. As noted, Canberra until recently promoted domestic manufacturers by supporting an import-substitution policy that involved high tariffs on manufactured imports, local content requirements for foreign investors and subsidies for local suppliers. The government realized in the late 1980s, however, that this policy had backfired. Inefficiencies were rife, potential foreign investors often were deterred by the local content rules, and the country's dependence on foreign sources of supply had increased. The decision to dismantle protectionist measures was designed in part to attract foreign investors that could help Australian manufacturers improve their competitiveness.

Investment and Technical Assistance

Government officials in both Australia and Japan understand that it is very difficult to change the traditional structure of bilateral trade in the short run. Thus, Canberra has sought Tokyo's help in facilitating the transfer of Japanese manufacturing product and process technologies and in encouraging the private sector to invest in Australia.

During the 1970s Japanese direct investment in Australia largely went into mining, particularly coal, as companies scrambled to gain access to low-cost sources of industrial supplies. Some money also went into the nonferrous metals industry, again to tap lower-cost supplies, and into the motor vehicle industry to avoid the high tariffs on cars and trucks. Japanese investment in Australia stagnated in the early 1980s, reflecting the economic slowdown in both countries. The appreciation of the yen and Canberra's decision to liberalize the investment environment for foreign businesses, however, have revived Japanese investors' interest in Australia. In the April 1989-March 1990 period, the latest fiscal year for which data are available, Japanese companies plowed $4.3 billion into Australian direct investments, nine times more than in the April 1985-March 1986 time frame. In fact, Japan has been the largest foreign direct investor in Australia on an annual basis since that country's FY 1987/88, although cumulatively its ranking remains third, after Great Britain and the United States.

Now, however, well over half of the $12.4 billion Japanese companies have invested in Australia is in real estate, services, particularly those related to tourism, and banking and finance. Not surprisingly, Canberra would

be happier if more money went into the manufacturing sector, which accounted for just 15 percent or so of cumulative Japanese investment as of March 1990. According to 1989 Australian statistics, over 80 percent of Japanese investment that year was channeled into the service sector, while 11 percent was earmarked for manufacturing and 6 percent for mining. In the same period 27 percent of American investment in Australia was directed to manufacturing and 17 percent to mining. Companies headquartered in the European Community put 29 percent of the money they invested in Australia into manufacturing and 14 percent into mining.

After complaints by Canberra about the short shrift Japanese investors were giving the manufacturing sector, the Ministry of International Trade and Industry in 1987 came up with the awkwardly named multifunction polis concept. The idea is analogous to MITI's technopolis plan, which is designed to stimulate local economies around the country by facilitating in each prefecture the establishment of specific high technology industries and associated academic research facilities. Then Prime Minister Noboru Takeshita and his Australian counterpart, Robert Hawke, endorsed the multifunction polis idea at a 1988 summit meeting.

Last year the Australian government decided to construct as a national project a multifunction polis in Adelaide, the capital of South Australia. The blueprint lays out a high technology research-related industrial city with a prospective population of 100,000. The cost of the project by the year 2010 is estimated at A$17.7 billion (U.S.$13.8 billion at A$0.78=US$1.00). The Australian federal and state governments will cover 20 percent of the construction costs, primarily those linked to infrastructure; the rest is to be financed by the private sectors in both Australia and Japan and, possibly, third countries. The multifunction polis is expected to be a model high technology research center that helps to upgrade the competitiveness of Australia's manufacturing sector as a whole.

Although the ruling Labor Party is portraying the project as a symbol of cooperation with Japan, the opposition parties, a coalition of the Liberal Party and the National Party, are skeptical of the concept and cautious about Japanese involvement in domestic industrial policy formulation. Some environmental activists also have expressed concern about the destruction of a mangrove forest at and surrounding the construction site.

The plan for the multifunction polis and concern about the increase in Japanese investment became key issues in the 1990 general elections. Although the Hawke government narrowly squeaked out a victory, just exceeding a majority in the lower house, the fact that almost half of the electorate supported the opposition was interpreted to mean that many Australians are uneasy with the development idea advanced by MITI as well as both the level and the type of Japanese direct investment in their country.

With the Australian public appearing cool to the multifunction polis project, Japanese businesses have been slow to get involved. Although almost 80 Japanese companies are listed as belonging to a group formed to study the plan, less than 30 are manufacturers, including only nine involved in the high technology areas of electronics and telecommunications equipment. The majority of the businesses interested in the plan are contractors, trading houses, banks and other service companies -- in other words, firms outside the research and

development field. From the viewpoint of Japanese manufacturers, Australia is not as attractive as a production or research site as Singapore, Malaysia and other Asean (Association of Southeast Asian Nations) members. Improvement of Australia's nationwide transportation system and more government involvement in the settlement of industrial disputes no doubt would instill greater confidence in Japanese investors. Also mentioned by Japan's business community as a prerequisite for more investment is further liberalization of Canberra's investment regulations. Without these moves, the Adelaide demonstration project may have few spin-offs.

Although Japanese investment activity in the Australian manufacturing sector and transfers of production technology have been comparatively limited, there have been some success stories. A Japanese food processor, for example, set up a pilot farm in conjunction with a local beef packer to raise cattle and provide beef cuts that meet Japanese taste preferences. The company also cooperated in marketing the beef in Japan. In another case a Japanese automotive maker designed a 3000-cc car for production in Australia, some of which have been exported to Japan. This type of car fills a niche in Japan, where demand for high-quality, powerful cars is on the upswing. In a final example a Japanese electronics company has launched a joint research program in robotics and computer software technologies with the Australian National University, which has a well-established reputation in basic scientific research.

Increased Japanese investment activity and technology sharing depends on Australian enthusiasm for the multifunction polis concept and Canberra's willingness to provide a framework that encourages exports of manufactured products as well as a positive investment climate and adequate infrastructure. What Japanese companies may view skeptically are government-led projects. Understanding corporate Japan's relationship with government -- both the extent of cooperation and the limits of persuasion -- is as important to the Australian public and private sectors as an understanding of Australian attitudes is to potential Japanese investors.

Tourism and Mutual Understanding

The influx of Japanese tourists to Australia and the substantial investments there in real estate and tourism-related industries by Japanese companies have generated a great amount of local concern. Tourism from overseas generally not only stimulates related service industries but also may promote deeper understanding between people of different cultural backgrounds. A rapid increase in tourists from a particular country converging on selected sightseeing spots, however, has been known to cause problems with the host country's residents.

Japanese visitors to Australia surpassed the 300,000 mark last year, at least triple the number of five years ago. Although Japanese tourists going to Australia amounted to barely 3.2 percent of the total taking trips abroad in 1990, Australia is an increasingly popular destination. The gaggle of Japanese entertainment magazine reporters and television crews that followed a popular singer and actress who spent their honeymoon in Australia in 1987 helped to popularize the country for many Japanese honeymooners. The 1988 leisure exposition in Brisbane also attracted many young Japanese men and women, the group perhaps most willing and able to spend time and money on vacations abroad.

Accompanying the influx of tourists were Japanese investors. They bought luxury hotels, condominiums, golf courses and gift shops along the Gold Coast,

the Great Barrier Reef and other famous sightseeing spots. Purchases of a zoo that houses Australia's distinctive koala and a whole coral island stirred worries that Australians were losing ownership of their landmarks.

Beyond these fears was the inflationary impact of Japanese investment in tourism-related real estate. The cost of housing, land and even golf course fees jumped, resulting in, according to one news report, many young Australians giving up the idea of owning their own home or playing golf in spots frequented by sightseers. Similar critical articles and television programs have described Japanese honeymooners as flying in groups on a Japanese airliner to Australia where they travel on chartered buses with other Japanese couples and a Japanese tour guide, rush to a famous beach but stay only half an hour -- long enough to take a picture, stay in a Japanese-managed luxury hotel, and finally buy lots of gifts, many of which are made in Japan.

As exaggerated as these descriptions may be, they imply that Australians see Japanese tourists as interested in the country's natural attractions to the exclusion of Australian culture, the way of life there or society as a whole. This impression stems not just from how Japanese investors appear to be taking advantage of Australia's heritage. In the mid-1980s MITI proposed a Silver Columbia plan, designed to ease the strain on Japanese housing and services and to allow Japanese senior citizens the experience of living abroad, possibly in a more spacious and less costly country than Japan. When MITI unveiled the plan and included Australia as a potential destination without consulting Canberra, strong opposition surfaced among many Australians. The idea that about 100 families would live in a planned community with Japanese-managed stores, Japanese doctors and other signs of what appeared to be an exclusive Japanese colony in Australia struck residents as alien to their goal of being a multicultural society that seeks to harmonize people from different backgrounds. Although MITI immediately withdrew its plan, this episode overlapped with images of Japanese packaged tours advancing on Australia and added to Australian unease.

Another indication of the lopsided relationship between Australia and Japan is the extent of academic research on each other's politics, economy and culture. Many Australian universities have faculty grounded in Asian studies. Research on Japan ranges from classical novels to modern management skills. Moreover, Japanese is one of the most popular foreign language courses in Australian high schools.

Few Japanese academics, however, are interested in Australia. An association for Australian studies was organized just two years ago in Japan. In addition, while Australia's news media carry stories almost daily from Japan, only a few Japanese newspapers and broadcast stations follow events in Australia, even one as big as this month's high-level bilateral meeting in Canberra, attended by six ministers and two vice ministers from Japan.

Political Relations May Expand

The early May ministerial-level talks in Canberra attracted far more attention from Japanese officials than has been evident in the past. Tokyo is interested in playing a more active international political role in the post-Cold War world, one that befits its economic power. One potential forum involving

Australia is the Asia Pacific Economic Cooperation conference. Proposed by Australian Prime Minister Hawke in January 1989 as a Pacific counterpart of the Paris-based Organization for Economic Cooperation and Development, APEC has taken shape slowly. The group's primary focus is the development of economic ties among Asian Pacific countries, not creation of a trade bloc. The European Community and the proposed free trade zone encompassing the United States, Canada and Mexico, however, have given added impetus to creation of an Asian Pacific entity. Japan's position as the only Asian nation among the Group of Seven industrialized democracies and the sole Asian member of the OECD (Australia and New Zealand, while also OECD members, are considered part of Oceania) -- not to mention the size of its economy -- makes it a natural linchpin for an Asian-based trade group.

Although Canberra has courted ties with Japan for a regional grouping and investment in manufacturing, Australian officials do not see eye-to-eye with their Japanese counterparts on certain issues. That is especially true of agricultural trade reform. Australia is one of the leaders of the Cairns group, which has pushed strongly in the Uruguay Round for an end to agricultural production and export subsidies as well as the removal of import barriers. Japan, however, has stuck to the position that countries should be allowed to retain quotas or other import restrictions on some commodities for food security reasons.

In the security area Australia, on occasion, has been less willing to forget Japanese aggression during World War II than other nations. In fact, a primary motivation behind the 1951 security treaty signed by Australia, New Zealand and the United States was to prevent Japan from becoming an aggressor again in the Pacific. Recently, however, Australia indicated it welcomed Tokyo's decision to send minesweepers to the Persian Gulf after hostilities ended there. Tokyo and Canberra also have cooperated on several regional peace plans, such as the Cambodian peace talks, although Tokyo has shown little interest in Canberra's proposal for comprehensive regional security arrangements or an Asia-based counterpart to the Conference on Security and Cooperation in Europe.

Conclusion

As often happens with economic superpowers, relations with neighboring countries can be lopsided. Japan's gross national product is more than 10 times bigger than Australia's. And while bilateral trade makes up almost a quarter of Australia's two-way trade, it represents only about 4 percent of Japan's overall exports and imports. Since Japan's economic influence on Australia, whether through trade, investment or tourism, is more extensive than Australia's economic impact on Japan, it is not surprising that Australians pay considerable attention to, and are cautious about, Japanese attitudes and views.

The mutually supportive Japan-Australia trade relationship has not necessarily resulted in mutual benefits for the two participants. Although both governments have taken steps to encourage Australia's manufacturing sector, those moves have been frustrated to some extent by other problems, including limited interest in collaboration among many members of Japan's business community.

Until recently both American and Japanese commentators on their respective country's economic relations with the other have tended to focus on the

transpacific trade imbalance. The imbalance, however, is only one of the problems straining the U.S.-Japan relationship. Unlike the Japan-Australia case, the U.S. economy remains almost twice as large as Japan's. Many Americans, however, view the U.S.-Japan relationship as symbolic of a shift in comparative economic power. In this context, Japan's influence on the American economy often is exaggerated in American attitudes. Similarly, Australian complaints about Japan carry echoes of Americans' perceptions of Japan.

For further information, contact Tadashi Saito.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

JEI Report will not be published May 31, 1991 because of the Memorial Day holiday. The next issue will be dated June 7, 1991.

NOTE

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